

Office of Chief Counsel
Internal Revenue Service
Memorandum

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subject: Section 447(i)(5)(C) Definition of "Applicable Portion"

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

For purposes of calculating the amount that a suspense account should be reduced pursuant to § 447(i)(5)(B), is the "applicable portion" always the same dollar amount during the first 20 years or does it change if the suspense account was reduced in a preceding year by an amount less than the applicable portion for that year?

CONCLUSION

The applicable portion for a taxable year will be greater than the applicable portion for a prior year whenever the suspense account was reduced in a prior year by an amount less than the applicable portion for that year.

LAW AND ANALYSIS

Section 447(i)(5)(B) provides as follows:

(B) PHASEOUT OF EXISTING SUSPENSE ACCOUNTS.—

(i) IN GENERAL.—Each suspense account under this subsection shall be reduced (but not below zero) for each taxable year beginning after June 8, 1997, by an amount equal to the lesser of—

(I) the applicable portion of such account, or

(II) 50 percent of the taxable income of the corporation for the taxable year, or, if the corporation has no taxable income for such year, the amount of any net operating loss (as defined in section 172(c)) for such taxable year.

For purposes of the preceding sentence, the amount of taxable income and net operating loss shall be determined without regard to this paragraph.

(ii) COORDINATION WITH OTHER REDUCTIONS.—The amount of the applicable portion for any taxable year shall be reduced (but not below zero) by the amount of any reduction required for such taxable year under any other provision of this subsection.

(iv) [sic] INCLUSION IN INCOME.—Any reduction in a suspense account under this paragraph shall be included in gross income for the taxable year of the reduction.

Section 447(i)(5)(C) provides that, for purposes of § 447(i)(5)(B), the term “applicable portion” means, for any taxable year, the amount which would ratably reduce the amount in the account (after taking into account prior reductions) to zero over the period consisting of such taxable year and the remaining taxable years in such first 20 taxable years.

Section 447(i)(5)(D) provides that any amount in the account as of the close of the 20th year referred to in § 447(i)(5)(C) shall be treated as the applicable portion for each succeeding year thereafter to the extent not reduced under this paragraph for any prior taxable year after such 20th year.

You have informed us that some taxpayers have calculated the applicable portion for their first taxable year beginning after June 8, 1997, and then used that same amount as the applicable portion throughout the first 20 years even though their suspense account was reduced in a prior year by an amount less than the applicable portion for that year. In other words, those taxpayers fail to calculate the applicable portion on an

annual basis and, consequently, fail to increase it in taxable years following years where the suspense account was reduced by an amount less than the applicable portion pursuant to § 447(i)(5)(B)(i)(II). We believe that practice is contrary to the plain language of the statute.

Section 447(i)(5)(C) provides that “the term ‘applicable portion’ means, for **any taxable year**, the amount which would **ratably** reduce the amount in the account **(after taking into account prior reductions)** to zero over the **period consisting of such taxable year and the remaining taxable years** in such first 20 taxable years” (emphasis added). Accordingly, we conclude that the applicable portion should be calculated on an annual basis during the first 20 years and that the applicable portion for a taxable year will be greater than the applicable portion for a prior year whenever the suspense account was reduced in a prior year by an amount less than the applicable portion for that year.

The alternative approach -- calculating the applicable portion only once at the beginning of the 20-year period, using that same amount as the applicable portion for each of the first 20 years, and then taking any remaining amount (resulting from the application of § 447(i)(5)(B)(i)(II)) into account in the following year or years -- reads the above emphasized language out of the statute. Section 447(i)(5)(C) specifically requires that the prior years’ reductions be taken into account before the current year’s reduction is computed. This can be done only if the applicable portion is recalculated each year by apportioning the amount remaining in the suspense account ratably over the remaining years.

If you have any further questions, please call Robert Basso at (202) 622-4950.